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In the Supreme Court of the United States

OCTOBER TERM, 1961

No. 562

HARRY AND AMANDA SCHROEDER, PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The memorandum findings of fact and opinion of the Tax Court (R. 433–67) are not officially reported. The opinion of the court of appeals (Pet. 1a–10a) is reported at 291 F. 2d 649.

JURISDICTION

The judgment of the court of appeals was entered on June 23, 1961 (Pet. 2). An extension of time to November 20, 1961, for filing the petition for certiorari was granted. The petition for a writ of certiorari was filed on November 20, 1961. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTIONS PRESENTED

1. Whether both courts below correctly decided that taxpayer's [1] income for the years 1944–1947 had been properly computed by the Commissioner of Internal Revenue under the net worth method.

2. Whether both courts below correctly decided that fraud penalties for the years 1944–1946 should be assessed against taxpayer.

STATUTE INVOLVED

Internal Revenue Code of 1939:

> SEC. 41. GENERAL RULE.
>
> The net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made in accordance with such method as in the opinion of the Commissioner does clearly reflect the income * * *
>
> (26 U.S.C. 1952 ed., Sec. 41.)
>
> SEC. 293. ADDITIONS TO THE TAX IN CASE OF DEFICIENCY.
>
> * * * * *
>
> (b) *Fraud.*—If any part of any deficiency is due to fraud with intent to evade tax, then 50

[1] Taxpayer's wife, Amanda Schroeder, is a party by virtue of joint income tax returns filed for the years 1946 and 1947.

per centum of the total amount of the deficiency (in addition to such deficiency) shall be so assessed, collected, and paid, in lieu of the 50 per centum addition to the tax provided in section 3612(d)(2).

(26 U.S.C. 1952 ed., Sec. 293.)

STATEMENT

Taxpayer Harry Schroeder was in the cattle feeding business. He purchased matured, grass-fed cattle from livestock commission merchants, brokers and dealers in several western states. The cattle were brought to taxpayer's feed lots, where they were commingled irrespective of the date of purchase or the price paid. They were then fed until they reached marketable weights, at which time they were sold as beef cattle. (R. 435–36.)

No books were kept by taxpayer with respect to his cattle feeding operations. The principal portion of his business was handled over the telephone and no records or memoranda were made as to these transactions. The records of taxpayer's operations consisted of such documents as bank statements, liability ledger sheets, cancelled checks, bills of sale and purchase invoices. No actual head count or physical inventory of taxpayer's livestock was taken prior to September 27, 1947, nor did he maintain separate records or identification of the various herds. (R. 436, 438.)

Taxpayer filed income tax returns for the years 1944–1947, showing the following figures (R. 440):[2]

Year	Net income	Tax liability
1944	$486.95	None
1945	11,839.86	$2,925.75
1946	51,500.00	25,479.00
1947	22,135.18	7,234.91

According to statements of financial condition submitted by taxpayer to his bank, his net worth increased by approximately $680,500 in the period between April 29, 1944, and February 10, 1947 (R. 448). Taxpayer reported his income on the cash receipts and disbursements basis (R. 436). The Commissioner of Internal Revenue, computing taxpayer's income on the net-worth basis, determined his net taxable income for the years 1944–1947 as follows (R. 441):

Year	Net taxable income
1944	$164,096
1945	160,219
1946	415,640
1947	310,655

The Tax Court, apart from conceded or minor adjustments, substantially sustained the deficiencies in income tax determined by the Commissioner for the years 1944–1947, together with the imposition of fraud penalties for the years 1944–1946, and a delinquency penalty for 1946 (R. 434–467). The decision of the Tax Court approved deficiencies in income tax

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[2] The amounts for 1946 are as indicated on what was only a "tentative" return. A return filed on July 15, 1948, showed net income of $243,099.64 and a tax liability of $185,374.14. The amended return for 1947 filed by taxpayer on July 31, 1948, showed income of $249,506 and a tax liability of $190,480.55.

and additions to tax in the following amounts (R. 480–481):

Year	Tax	Additions to tax	
		Section 293(b)	Section 291(a)
1944	$127,014.50	$63,807.28	
1945	121,082.88	60,541.44	
1946	149,442.02	158,558.42	$79,279.21
1947	44,560.62		

Upon review, the decision of the Tax Court was affirmed in all respects (Pet. 1a–10a).

ARGUMENT

1. The issues in this litigation are primarily factual and have been resolved against the taxpayer by the two courts below. These concurrent findings are not to be disturbed except upon a clear showing of error. *Comstock* v. *Group of Investors*, 335 U.S. 211; *Corn Products Co.* v. *Commissioner*, 350 U.S. 46, 50. We submit that the decision below has ample support in the record and that there is no occasion for further review.

The focal point of taxpayer's attack continues, as below, to be the computation of his opening net worth (Pet. 2–5). The method applied by the Commissioner is based on the premise that only cattle purchased by taxpayer within the last 90 days of the year were still on hand at the end of the year, and, consequently, at the beginning of the following year (Pet. 3a–4a; R. 461–462). As the evidence clearly shows, the 90-day cutoff method was geared to the business facts of this particular taxpayer's operation as a cattle feeder,

and both the Tax Court and the court of appeals agreed that the use of this method was not only justified but compelled (Pet. 6a–7a; R. 462, 463).

Briefly summarized, the evidence in support of the Commissioner's premise showed that (1) in effect both the taxpayer and his accountant recognized the propriety of the use of a method similar to the 90-day cutoff method in computing net worth (Pet. 6a–7a; R. 436–37); (2) taxpayer himself advised the Internal Revenue agents that his feeding period ran from 90 to 110 days (R. 342, 408); (3) the cost basis for cattle on hand December 31, 1946, based upon the only physical head count ever made (on September 27, 1947) actually matched the purchase of livestock during the last 86 days of 1946 (R. 436, 462); (4) the results reached by application of the 90-day cutoff method were found by the Tax Court to be reasonable when checked against other testimony and documents in the case, including taxpayer's statements of financial condition submitted to banks, his liability ledger sheets and the abstracts of his mortgages on cattle (R. 462–63).

The factual contentions on which taxpayer bases his attack on the Commissioner's computation are unfounded, as a few examples will show. A chart has been constructed (Pet. 10–11) purporting to show lengthy holding periods based upon mortgage records allegedly introduced as exhibits at the trial. Upon turning to the record reference offered (R. 598–600), it will be observed that mortgages are listed in the petition that were not offered at the trial and that taxpayer has assumed—with no record support whatsoever—that the dates on which the mortgages finally

were released as of record at the courthouse were the dates of sale of the cattle. In like vein, taxpayer contends (Pet. 12, 23) that the mortgages on his cattle as of December 31, 1943, exceeded the Commissioner's computation of cattle on hand as of that date. Taxpayer overlooks the fact that the mortgages included corn and feed in amounts up to 22,000 bushels per single mortgage (R. 599) and that corn was valued at or about that time at $1 per bushel (Supp. R. 20). Similarly, apparently intending to convey the impression that inventories were a regular undertaking, taxpayer persists in referring to "physical inventories" of his cattle by himself, his accountant or a bank (Pet. 7, 8, 13, 14), whereas the record shows (1) that, as both courts below found, the only actual head count taken by taxpayer was in September 1947 (Pet. 3a; R. 436, 461–62) (on which count the Commissioner's computations were based, Pet. 3a–4a), (2) that the "physical inventories" on which his accountant based his tax returns were exclusively "in [the taxpayer's] head" (R. 146–47), and (3) that the "bank inventories" consisted of certain general financial statements submitted by taxpayer to his bank, which the president of the bank said he had investigated as to accuracy (R. 200–01).

2. Neither the result reached by the court of appeals nor its reasoning is in conflict with any other appellate decision. Taxpayer mistakenly asserts the existence of a conflict among the circuits, representing that in the Eighth and Third Circuits an arbitrary net worth computation obtains "rubber stamp approval," and that it is only in such courts as the

First, Fifth and Sixth Circuits that "a determination based on guesswork is not entitled to the presumption of correctness" (Pet. 16–17). This proposition, astonishing on its face, is not supported by the excerpts from the opinions reproduced in the petition (Pet. 17–19) nor by the text cited by taxpayer (Pet. 16) as his only other authority.

The question to be decided in a case of this type is whether the Commissioner proceeded on the basis of evidence. As the court below aptly observed in *Gunn* v. *Commissioner*, 247 F. 2d 359, 362:

> * * * the fixing of an opening net-worth figure is a matter of getting at actual economic fact, and of not allowing reality to be obscured by engaging solely in a rigid tax-incident glance. And it is for this reason that the question of its fairness or correctness should not too loosely be allowed to be brushed under the rug of Commissioner presumption.

Moreover, the court below has not hesitated to reverse the Tax Court upon those occasions when, in its opinion, the Commissioner and the Tax Court have strayed from the rule as stated. See *Gunn* v. *Commissioner*, *supra*, and *Marcella* v. *Commissioner*, 222 F. 2d 378 (C.A. 8). More importantly, however, as we have shown above, the determination of the Commissioner in this case was firmly grounded in evidence accepted by the Tax Court, whose findings with respect thereto have been weighed and approved by the court of appeals under the prescribed standard of review stemming from the "clearly erroneous" doctrine (Pet. 7a).

Similarly without merit is taxpayer's contention that the decision below is in conflict with *Carter* v. *Campbell*, 264 F. 2d 930, 936 (C.A. 5). The substance of taxpayer's argument is that in any case where income tax deficiencies are upheld solely on the basis of the presumption of correctness attaching to the Commissioner's determination and the only evidence of fraud is the substantial understatement of income reflected in those deficiencies, taxpayer, in effect, has had thrust upon him the burden of disproving fraud. He cites *Carter* v. *Campbell* for the general proposition that failure to disprove a deficiency determination does not create a presumption of fraud (Pet. 20–22). The basic infirmity in this argument of the taxpayer is that it is predicated upon a hypothetical situation which does not exist in this case. Here, despite the observation of the court below that the burden of disproving the deficiency determination was upon taxpayer, the court went on to recognize that fraud must be proved by the Commissioner by clear and convincing evidence (Pet. 6a–7a). Contrary to taxpayer's assertion, it is evident that the deficiencies involved were not approved by the court of appeals on the basis of any presumption, but upon a sifting of the evidence in a fully developed record supporting the findings of the Tax Court (Pet. 7a–9a). In like manner, the court of appeals found substantial evidence in the record to support the finding of fraud by the Tax Court (*ibid.*). That evidence included not only gross and repeated understatements of income in his tax returns, together with other indicia of willful

inaccuracy on the part of taxpayer such as contemporaneous financial statements disclosing far greater income, but also the alteration of checks forming the basis for attempted deductions from income[1] and the demeanor testimony of the taxpayer. As this Court has stated, "Findings as to the design, motive and intent with which men act depend peculiarly upon the credit given to witnesses by those who see and hear them." *United States* v. *Yellow Cab Co.*, 338 U.S. 338, 341.

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be denied.

Respectfully submitted.

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JANUARY 1962.

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[1] Taxpayer's attempt at explaining away these alterations (Pet. 14, n. 7) is wholly without foundation. As the Tax Court found (which findings were set forth *in extenso* by the court below, Pet. 8a–9a), not only did the record establish that the alterations contributed directly to the understatements of income involved in this case (R. 331–32, Supp. R. 2–16, 43–46), but it fairly supported the inference that they were made for that express purpose (R. 446–47).

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